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Supreme Court of the United States

OCTOBER TERM, 1954

NO. 194

GREGORY RUN COAL COMPANY, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NO. .....

J. E. VINCENT, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NO. .....

J. E. VINCENT COMPANY, INC., Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NO. .....

J. E. VINCENT COMPANY, INC., Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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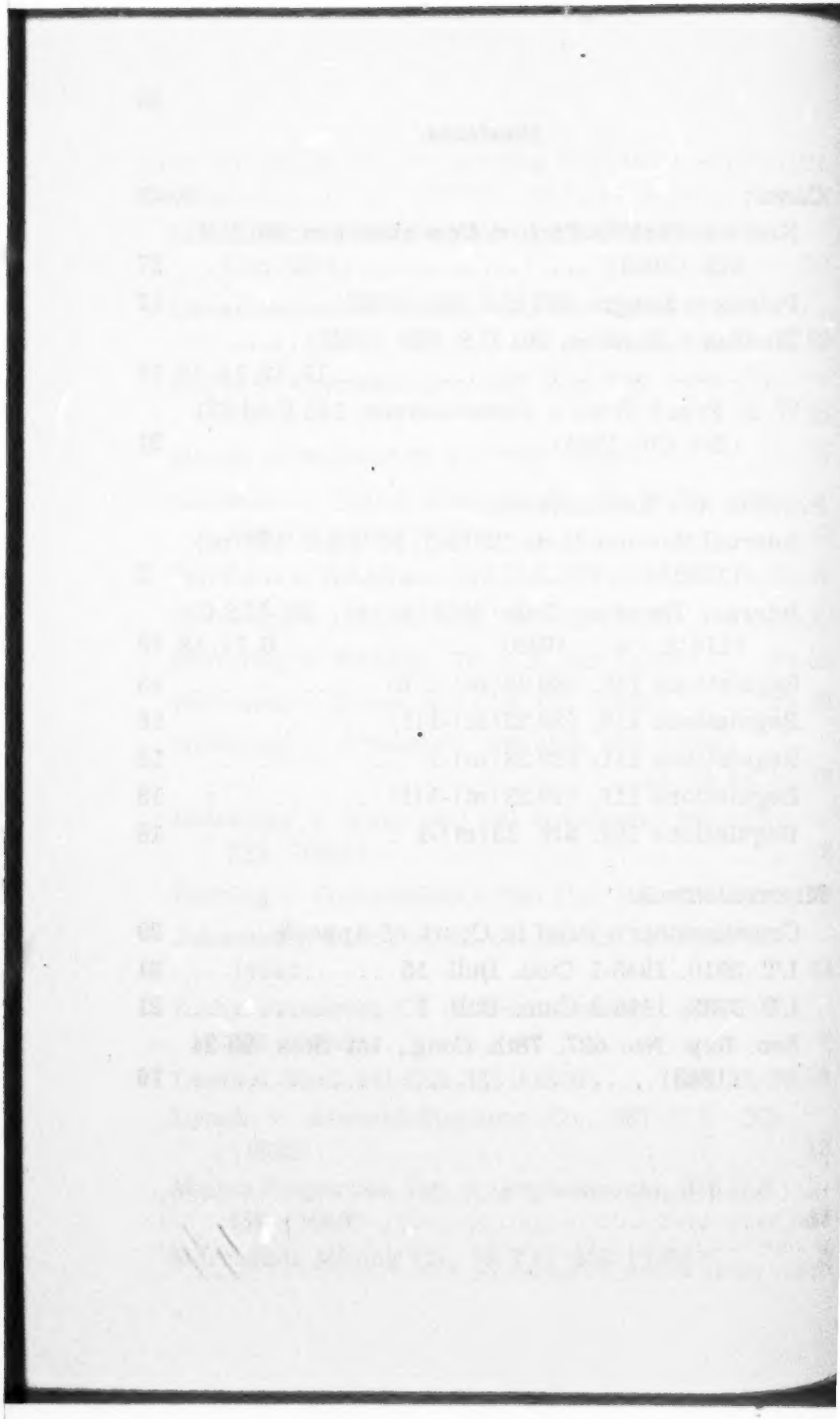

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The petitioners pray that a writ or writs of certiorari issue to review the judgments of the United States Court of Appeals for the Fourth Circuit, entered in the above-entitled cases on April 9, 1954.[1]

I.

OPINIONS BELOW

The opinion of the Tax Court of the United States (App. 1) is reported in 19 T. C. 501 (1952). The opinion of the Court of Appeals (App. 52) is reported in 212 F.2d 52 (4th Cir. 1954).

II.

JURISDICTION

The judgments of the Court of Appeals (App. 79) were filed and entered on April 9, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1) (1946).

III.

QUESTIONS PRESENTED

1. Does a coal miner have the right to apply the Federal income tax percentage depletion deduction to his

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1. These four cases were tried and decided together by the Tax Court. They were consolidated for review by the United States Court of Appeals for the Fourth Circuit, and were dealt with in one opinion by that Court. There is one issue which is common to all four cases and another issue which is embedded in but one of the cases.

compensation for mining the coal, when he cannot be charged for Federal income tax purposes with the gross income derived from the sale of the coal because he does not own it, either in place or upon severance?

2. If that coal miner is entitled to the percentage depletion deduction, must the amount of his compensation be deducted from the gross income attributable to the sale of the coal by the person who paid that compensation, who alone owned the coal upon severance, and who alone is chargeable for Federal income tax purposes with the gross income from the sale thereof, in computing that person's percentage depletion deduction?

3. Is the controlling shareholder of a corporation taxable with the income derived by the corporation from severed coal, which had been transferred by the shareholder to the corporation, because the shareholder has the power to recapture possession, from the corporation, of the coal field from which that coal was taken?

IV.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions are (1) 26 U.S.C. §23(m) (1946); and (2) 26 U.S.C. § 114(b) (4) (1946). The pertinent regulations are Reg. 111, § 29.23(m)-1, 26 Code Fed. Regs. § 29.23(m)-1 (1943 Supp.). The statutory provisions and the regulations are printed in the Appendix. (App. 76).

V.

STATEMENT OF THE CASE

These cases commenced in the Tax Court, whose jurisdiction was invoked under Section 272 of the Internal Revenue Code, 26 U.S.C. § 272 (1946 Supp.). See, also, Section 1101 of Internal Revenue Code, 26 U.S.C. § 1101 (1946).

The percentage depletion issue is common to all four of the cases involved here. These are the facts with respect to that issue.

The petitioners leased some coal lands in West Virginia and agreed to pay the lessors royalties ranging from 10¢ to 12¢ per ton.

In 1945, Gregory Run Coal Company (herein called "Gregory Run") made a contract with a stripping contractor by the name of Summit Fuel Company (herein called "Summit"). In the contract, Gregory Run agreed to furnish all the machinery and equipment needed by Summit in strip-mining coal from the land Gregory Run held under its lease. Summit was to supply the labor and motor vehicles, strip-mine the coal and process it through Gregory Run's tipple into the railroad cars. Gregory Run was to market the coal. Summit promised to backfill the land in accordance with the laws of West Virginia, to carry Workmen's Compensation and liability insurance, and to build any roads necessary to the operation.

With respect to compensation, Summit and Gregory Run agreed: "All money arising from the sale of said coal shall be paid to Gregory, and for its participation in

this joint adventure Summit shall receive one and 55/100 dollars ($1.55) per net ton for all coal mined, transported and loaded by it, which shall be paid to it on the 25th day of each month for all coal mined and loaded during the preceding month." The contract could be cancelled upon thirty days' notice if "either Gregory or Summit are dissatisfied with this distribution."

From June 11 to December 31, 1945, Summit stripped and hauled the coal from the property, for which Gregory Run paid it $222,617.43. Beginning July 1, 1946, however, Gregory Run did all the stripping and Summit merely hauled the coal. Gregory Run paid Summit $189,005.63 for stripping and $86,367.19 for the hauling it did during 1946.

The Commissioner included those amounts it paid Summit in Gregory Run's gross income for the years 1945 and 1946, and then excluded them from Gregory Run's gross income solely for the purpose of computing its percentage depletion deduction for those years. He also allowed those amounts as business expense deductions from Gregory's gross income during those years.

The Tax Court decided that Gregory Run was not required to exclude those amounts from its gross income for the purpose of computing the percentage depletion deduction to which Gregory Run was entitled during the taxable years 1945 and 1946. It found that "Summit was not to receive payment in kind or as a percentage of the selling price or profit; it was to receive a stated price per ton of coal; payment was to be made at stated intervals and was independent of whether or when Gregory Run sold the coal." (App. 40). It held that Summit had no economic interest in the coal in place, and relied in

this regard upon *Morrisdale Mining Co.*, 19 T.C. 208 (1952). In that case the Tax Court held that a stripper had no economic interest in the coal in place because it was not paid with a percentage of either the coal produced or of the proceeds derived from its sale. Hence, the Tax Court concluded here, since Summit was not entitled to percentage depletion with respect to the compensation paid it by Gregory Run, Gregory Run was not required to exclude the sum of that compensation from its gross income for the purpose of computing its percentage depletion deduction.[2]

The stripping contracts in the J. E. Vincent (herein called "Vincent") and J. E. Vincent Company, Inc. (herein called "Vincent, Inc.") cases were much like the one Gregory Run had with Summit, except with respect to the strippers' compensation.

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2. This Court has stated as a general rule that there is but one percentage depletion deduction which must be apportioned among the holders of economic interests relating to the property. See, e.g. *Helvering v. Twin Bell Oil Syndicate*, 293 U.S. 312, 321 (1934); *Kirby Petroleum Co. v. Commissioner*, 326 U.S. 599, 605 (1946). The Code merely requires that that deduction be apportioned between lessors and lessees, life tenants and remaindermen, and income beneficiaries and trustees. I.R.C. § 23(m), 26 U.S.C. § 23(m) (1946). The Code section dealing with the percentage depletion of coal mines merely requires that "rents or royalties paid or incurred during the taxable year" be excluded from gross income in the computation of the deduction. I.R.C. § 114(b)(4), 26 U.S.C. § 114(b)(4) (1946). The Code says nothing about apportioning the deduction between the producer and a stripper, or about excluding the amounts paid a stripper from the producer's gross income, and the inference is that it shall not be done.

Vincent made two stripping contracts, one with the Swaney Contracting Company and the other with B. H. Swaney and Sons, Inc. (these companies are herein called the "Swaneys"). Under those contracts, the Swaneys were paid a flat sum, to be adjusted by reference to the sales price of the coal, for each ton of coal sold by Vincent. That is to say, the right of the Swaneys to their compensation was fixed by Vincent's sale of the coal. But, the contract provided: "In case said Weaver Coal Company, or such other sales agent as may hereafter have charge of the sale of said coal, shall fail to pay [Vincent] for any coal so loaded and shipped, such default shall not, in any case relieve [Vincent] from his obligation to pay [the Swaneys] the price provided by this agreement and on the basis and at the times herein provided."

Vincent operated under these contracts for awhile, and eventually assigned his leases to Vincent, Inc. Vincent (with respect to a part of the year 1947) and Vincent, Inc. (with respect to its 1947 and 1948 fiscal years) both claimed percentage depletion deductions from their gross income, for income tax purposes, computed without excluding from that income the amounts they paid the Swaneys. The Commissioner determined that that was erroneous, but the Tax Court sustained Vincent and Vincent, Inc. for the reasons given in the Gregory Run case.

The other issue involved here—the income issue—relates only to Vincent.

In September and October 1945, Vincent obtained leases of coal lands located on Lambert's Run in West

Virginia from the Dawson Coal Company (herein called "Dawson") and some people by the name of Thrasher. Likewise in 1945, he executed the stripping contracts, previously referred to, with the Swaneys.

Sometime before April 30, 1947, Vincent was hospitalized and thus was unable to look after his business. His son returned from military service with the Eighth Air Force and did some work about the Lambert's Run property. Vincent decided that his son should have an interest in the business, and thus Vincent, Inc. was formed on April 30, 1947 to take over the business represented by the Lambert's Run property. Vincent paid in $6,000. His son and his wife each paid in $1,000, money which originated with them. Vincent acquired 60 shares and his wife and son each received 10 shares in the corporation.

Dawson, however, refused to sanction the assignment of its lease to Vincent, Inc. When this was reported to the directors of Vincent, Inc. on May 15, 1947, they promptly adopted a resolution that "the corporation would operate the said coal without a formal assignment of the leases * * * on the same basis as said operations would have been conducted if said assignment had been made * * *."

The same day Vincent made a written agreement with Vincent, Inc. It leased the tipple, sidetrack, buildings, grounds and appurtenances from Vincent, and acquired the right to load over the tipple coal mined on Lambert's Run and any other coal in that area under lease to Vincent. Under the agreement, Vincent, Inc. paid Vincent as rent 5 cents for each ton of coal it loaded over the tipple.

Vincent, Inc. was obligated under the agreement to shoulder the cost of operating the tipple and the surrounding property. It was bound to keep the tipple and sidetrack property "in good operating condition" and to return them "in as good condition as they now" are, "ordinary wear and tear excepted."

The agreement further provided that Vincent was to continue to operate in his own name the Lambert Run mines and was to "be regarded as the operator of said coal", subject only to the B. H. Swaney and Sons, Inc. contract. Vincent was to receive the proceeds from the sale of the coal "loaded over the tipple and sidetrack" and out of those proceeds was to pay such things as brokerage, royalties for coal, the amount due him as rental for the use of the tipple and sidetrack, and state taxes on mining operations. The residue, termed the "net proceeds", was to be paid over to Vincent, Inc., and out of it Vincent, Inc. was obliged to pay B. H. Swaney and Sons, Inc. for stripping the coal. The agreement could be cancelled by either party on 30 days' notice.

Between June 30, 1947 and December 31, 1947, Vincent turned over to Vincent, Inc. $808,064.46 as "net proceeds" from the sale of the coal taken from the Dawson and Thrasher properties. Between May 1, 1947 and December 31, 1947, Vincent, Inc. paid the Swaneys a total of $448,379.25. Indeed, Vincent, Inc. paid or incurred total expenses of $671,709.71 with respect to its operations during the period May 1 to December 31, 1947.

Around December 1, 1947, Vincent learned that Dawson would not object to an assignment of its lease to Vincent, Inc. The same day, Vincent gave notice of his intent to cancel the May 15, 1947 agreement as of

January 1, 1948. Subsequently, on January 2, 1948, he assigned the leases pertaining to the Lambert's Run property to Vincent, Inc. After the assignment, the proceeds from the sale of the coal were paid directly to Vincent, Inc.

The Tax Court specifically found that Vincent, Inc. maintained "a complete set of books showing the results of its operations" and "its own bank account." (App. 27).

The Commissioner determined that the $808,064.46 which Vincent turned over to Vincent, Inc. during 1947 was taxable to him income tax-wise and allowed Vincent as "additional deductions" the $565,743.67 actually paid out for expenses by Vincent, Inc. during that year. However, the Commissioner determined that Vincent, Inc. alone was taxable with the net income derived from the sale of the coal in 1948.

The Tax Court sustained the Commissioner with respect to the income issue on two distinct grounds. First, it said that "The net result of the arrangement between Vincent and Vincent, Inc., was that Vincent paid over to the corporation income earned by him as an operator of coal properties and as an owner of coal leases and other properties in connection therewith. This does not relieve him of tax liability on such income. *Lucas v. Earl,* 281 U.S. 111; *Helvering v. Horst,* 311 U.S. 112; *Harrison v. Schaffner,* 312 U.S. 579." (App. 46). Second, it noted that Vincent had the power to cancel "the contract on 30 days' notice. Through this he could control the flow of income. Under these facts, the income must be regarded as his. *Commissioner v. Sunnen,* 333 U.S. 591." (App. 46).

The Commissioner petitioned the Court of Appeals to review the Tax Court's decision with respect to the percentage depletion item in these four cases. Vincent petitioned the Court of Appeals to review the Tax Court's decision with respect to the income issue.

Meanwhile, the Swaneys had their case in the Tax Court. They claimed the right to apply the percentage depletion deduction to the compensation paid them by Vincent and Vincent, Inc. They lost in the Tax Court,[3] and their case caught up to these cases in the Court of Appeals because of a death in the family of one of the Government lawyers. The clerk of the Court of Appeals refused to grant Gregory Run, Vincent and Vincent, Inc. more than three days in which to prepare, print and file a reply to the brief which the Government filed with respect to the depletion issue, although the Government was given about three months to reply to Vincent's brief on the income issue.

In the Court of Appeals, the Government sided with the Swaneys, claiming that they were entitled to the percentage depletion deduction with respect to their compensation, and that thus the petitioners were required to exclude those amounts from their gross incomes for the purpose of the percentage depletion deduction only. The Court of Appeals, relying entirely upon *Burton-Sutton Oil Co. v. Commissioner,* 328 U.S. 25 (1946), reversed the Tax Court on the depletion issue in this case and in the Swaneys' case, and affirmed it on the income issue involved here.

This petition followed.

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3. The opinion was in memorandum form and was not officially published.

VI.

REASONS FOR GRANTING THE WRIT

A.

With Respect to the Depletion Issue.

1. The decision of the Court of Appeals is of extreme importance in the coal industry. (App. 74). The National Coal Association has said that a "large number" of its members "hire independent contractors, for a fixed amount per ton, to strip the overburden from coal and to load and haul the coal to the producer's tipple for processing by the producer and sale by the producer." (App. 74). It has said that "In many of such instances, as in the *Vincent* case, the Commissioner has taken the position that the producer's gross income upon which the percentage depletion is based must be reduced by the amount paid to the independent contractors." (App. 75). It further said (App. 75):

> "While only a comparatively limited number of such cases have reached the Tax Court as yet, if the Commissioner's position and the position taken by the Court of Appeals in the *Vincent* case is upheld, contrary to the position taken by the Tax Court, it will have far-reaching consequences in the bituminous coal producing industry and will affect adversely the interests of a great many coal producers."

2. The decision of the Court of Appeals conflicts with the principles set down by this Court in *Thomas v. Perkins*, 301 U.S. 655 (1937), *Helvering v. O'Donnell*,

303 U.S. 370 (1938), and *Anderson v. Helvering,* 310 U.S. 404 (1940).

In *Perkins,* the taxpayer was the assignee of some oil leases which provided for a royalty interest of one-eighth. The assignment stated that the assignors transferred all their interests in the leases to the taxpayer for a consideration of $10 cash and $395,000 " 'to be paid out of the oil produced and saved from the * * * lands, and to be one-fourth of all the oil produced and saved * * * until the full sum * * * is paid * * *.' "[4] This $395,000 was payable only out of the oil produced. The Commissioner included all of the income derived from the sale of the oil, including that payable to the assignors, in the taxpayer's income.

This Court held for the taxpayer. It said that *Palmer v. Bender,* 287 U.S. 551 (1933), a discovery depletion case, "supports the view that the assignment did not transfer the oil in question."[5] It said of the *Bender* case: "If Palmer had retained no interest in the oil he would have been entitled to no deduction on account of depletion. Ownership was essential. The assignee was not entitled to income from Palmer's share of the oil nor to deduct from the income it received from its own interest any part of the depletion allowance that was attributable to Palmer's interest."[6] This Court concluded its opinion by saying:[7]

"* * * The owner of an interest in the deposit is entitled to deduct for depletion of the part

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4. 301 U.S. at 657.
5. *Id.* at 659-660.
6. *Id.* at 661.
7. *Id.* at 663.

producing his income but may not deduct for depletion of a share belonging to another.

"As Hammonds and Branson, the assignors in this case, would be entitled to an allowance for depletion in respect of the oil sold out of their share, the income from that interest is not chargeable to respondents, Perkins and wife."

In the *O'Donnell* case, the taxpayer transferred his shares in the X corporation to the Y corporation in return for a promise by Y to pay one-third of the net profits derived from Y's operation of X's oil properties. The taxpayer claimed a depletion deduction with respect to the amounts he received from Y. This Court held he had acquired no depletable interest, for these reasons: (1) "The *ownership* of the oil and gas properties was in the corporation";[8] (2) "When [Y] acquired these properties from [X] and operated them, [Y] became the *owner* of the oil and gas produced;"[9] (3) "[Y] was the *owner* of the gross proceeds or income upon which the statutory allowance for depletion was to be computed";[10] and (4) "The agreement to pay respondent one-third of the net profits derived from the development and operation of the properties was a personal covenant and did not purport to grant respondent an interest in the properties themselves."[11] It followed, said this Court, that O'Donnell had a mere "economic advantage", not the requisite economic interest.

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8. 303 U.S. at 371. Emphasis added.
9. *Ibid.* Emphasis added.
10. *Ibid.* Emphasis added.
11. *Id.* at 372.

In its latest pronouncement on the depletion question, this Court said that *O'Donnell* was still the law.[12]

The *Anderson* case involved the question as to whether the taxpayer was chargeable, income tax-wise, with the proceeds derived from the extraction and sale of oil, which he turned over to another pursuant to a contract. This Court said that "It is settled that the same basic issue determines both to whom income derived from the production of oil and gas is taxable and to whom a deduction for depletion is allowable."[13] It held that "Petitioners, as purchasers and owners of the properties, are therefore taxable upon the gross proceeds derived from the oil production, notwithstanding the arrangement to pay over such proceeds to Oklahoma Company. See *Helvering v. Clifford*, 309 U.S. 331 * * *."[14]

Thus, as we see it, *Perkins, O'Donnell* and *Anderson* unmistakably establish the principle that only the person who is chargeable (income tax-wise) with the gross proceeds from the sale of the oil or mineral may take a depletion deduction. They likewise establish that only the person who owns the oil or mineral at the moment of its sale is the person who is chargeable with the gross proceeds of the sale. See *Commissioner v. Caldwell Oil Corp.*, 141 F. 2d 559, 561 (5th Cir. 1944).

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12. *Burton-Sutton Oil Co. v. Commissioner*, 328 U.S. 25, 35 n. 14 (1946): "A participation in net profits dissociated from an economic interest does not enable a recipient of such profits to benefit from depletion. *Helvering v. O'Donnell* * * *"

13. 310 U.S. at 407.

14. *Id.* at 413. The *Clifford* case involved the question as to who was taxable with the distributable income of a trust.

Under their leases, the petitioners here had the power to reduce the coal in place to their possession, by a severance of it. They had a power to acquire ownership of it, and thus owned a depletable interest. Whether they had title to the coal in place is not material. *Lynch v. Alworth-Stephens Co.*, 267 U.S. 365 (1925); *Burnet v. Harmel*, 287 U.S. 103 (1932); *Bankers Pocahontas Coal Co. v. Burnet*, 287 U.S. 308 (1932).

Now, if Summit and the Swaneys ever acquired a depletable interest, it must have come from Gregory Run and Vincent under the contracts.

They acquired no ownership of the coal through an agreement to split the production or its proceeds, for they were to get their compensation irrespective of whether Vincent or Gregory Run ever received any proceeds from the sale of the coal. They had a contractual duty to extract and haul the coal, but that never gave them any ownership of the coal. Any other conclusion on that score would be in headlong conflict with the agreement that they were to be paid in any event. Moreover, in Summit's case the duty to extract the coal, even if it could be turned into a right by way of semantics, was so illusory as not to be worth noticing. Gregory Run at its whim could snatch it away upon 30 days' notice.

Thus, it is perfectly clear that neither Summit nor the Swaneys ever acquired a depletable interest in the coal under the rule laid down in *Perkins, O'Donnell* and *Anderson*.

The decision of the Court of Appeals not only collides with the rule of the *Perkins, O'Donnell* and *Anderson* cases, but, in addition, has no real support whatso-

ever from *Burton-Sutton Oil Co. v. Commissioner,* 328 U.S. 25 (1946), upon which it relied entirely. In *Burton-Sutton,* the question involved was whether the assignor of the taxpayer had retained an interest in the oil in place despite the assignment. The assignor stipulated in the assignment that it was to receive 50% of the net income "from operations." The taxpayer deducted this 50% from its gross income for income tax purposes, and this Court held that that was proper. The assignor, it said, retained an economic interest in the coal in place and was entitled to apply the depletion deduction to the 50% of net it received.

The *Burton-Sutton* case is inconsistent with *Perkins, O'Donnell* and *Anderson,* at least to the extent that it held that the assignee could *deduct* the 50% of net it paid the assignor, for income tax purposes generally. *Perkins, O'Donnell* and *Anderson* would require that the 50% of net allocable to the assignor should never have been included in the assignee's gross income, for it was the assignor's income alone and not the assignee's at all. Be that as it may, *Perkins, O'Donnell* and *Anderson* were all cited with approval in *Burton-Sutton.*

Finally, we should like to repeat that this Court said in *Burton-Sutton* that the *transfer* of only a right to share in the proceeds of production does not vest a depletable interest in the transferee,[15] although the *retention* of that right only by a transferor gives him a depletable interest.

We submit that if the transferee of a right to share the proceeds of production does not *acquire* a depletable

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15. See note 12 *supra.*

interest by virtue the transfer, it follows that one who is saddled with a mere contractual duty to extract the mineral certainly does not *acquire* a depletable interest by the contract.

3. The error of the decision of the Court of Appeals is even clearer when it is set beside the very statute upon which it was based.

Section 114(b)(4) of the Code allowed in the case of coal mines and with respect to the years involved here, a depletion deduction of 5 per cent "of the gross income from the property during the taxable year." (App. 77)

If Vincent, Vincent, Inc. and Gregory Run had been on the cash basis of accounting and if they actually had not been paid for the coal which was sold in 1946 or in 1947, for example, there would have been no "gross income from the property" whatsoever during those taxable years, at least insofar as they were concerned. Nevertheless, they would have been required to pay the Swaneys and Summit their compensation. In such a case, would the Swaneys and Summit be entitled to percentage depletion? If they would, then it must be on some theory that their "property" is different than the "property" which Vincent, Vincent, Inc. and Gregory Run owned. It would necessarily follow that there are two properties and two gross incomes involved, in which event the general rule that there is but one depletion deduction which must be carved up among the holders of economic interests relating to the property,[16] would not require the petitioners to exclude from their gross income, for percentage depletion deduction purposes,

16. See note 2 *supra*.

the amounts they paid Summit and the Swaneys. This conclusion would be wholly consonant with the Commissioner's long standing interpretation of the word "property" in section 114 as meaning "the interest owned by the taxpayer in any mineral property."[17]

On the other hand, if there can be but one "property" (that "property" being the coal), and but one total "gross income" therefrom, *i.e.*, gross proceeds from the sale of the coal, it would seem that neither Summit nor the Swaneys in the case supposed could apply the depletion deduction to their compensation for the simple reason that there was no "gross income from the property during the taxable year." Compare *Herring v. Commissioner*, 293 U.S. 322 (1934).

It must be, therefore, that Summit's and the Swaneys' "gross income" was derived from Vincent, Vincent, Inc. and Gregory Run, not from any "property". Consequently, they never received "gross income from the property" during any taxable year and thus did not come within the plain terms of the statute.[18] That is to say, if they did not receive "gross

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17. See note 18 *infra*.

18. The Commissioner's own regulations have long proclaimed that no one has a depletable interest unless he secures "income derived from the severance and sale of the mineral." Reg. 118, § 39.23(m)-1(b); Reg. 111 § 29.23(m)-1; Reg. 101, art. 23(m)-1. They have also stated that the word "property", in the clause "gross income from the property," means "the interest *owned* by the taxpayer in any mineral property." Reg. 118, § 39.23 (m)-1(i); Reg. 111, § 29.23(m)-1(i). (Emphasis added.)

Despite these regulations, which are of some antiquity, the Court of Appeals said that "The fact that

income from the property" when there was no income from the sale of the coal, even though they were paid anyway, their compensation was not magically converted into "gross income from the property" when Vincent, Vincent, Inc. and Gregory Run alone became chargeable, income tax-wise, with the gross proceeds from the sale of the coal.[19]

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* * * in the pending case the *compensation* of the producer [i.e., the Swaneys and Summit] was fixed by the selling price of the coal, adjustable to changes in the market, is not significant; * * *." (App. 72) (Emphasis supplied). It never mentioned, let alone disposed of, the argument that the regulations themselves require that the income, to be depletable, must be derived from the sale of the mineral, i.e., arise out of the sale itself, as distinguished from the sale fixing the right to compensation. Moreover, the Court of Appeals expressly found (quite inconsistently with its decision, we believe) that Vincent and Vincent, Inc. paid the Swaneys for their "services" merely. (App. 69).

19. The fact that section 114 of the Code defines "gross income from the property" as meaning "gross income from mining", is of no moment. This definition came into being by the Revenue Act of 1943 and its purpose was to insure that all of the proceeds from the sale of the mineral were to be subject to the percentage depletion deduction provided they were attributable to "ordinary treatment processes", as well as actual extraction. Sen. Rep. No. 627, 78th Cong., 1st Sess. 23-24 (1943). To use the definition as an expansion of the percentage depletion deduction with respect to taxpayers entitled to it not only would run afoul of the expressed purpose behind its insertion into the Code, but, in addition, would impel a fantastic conclusion that a railroad which builds a spur at its own expense into the coal field, and contracts for the shipment of all coal produced to a processing center less than 50 miles away, can apply the percentage depletion deduction to the amounts it receives for hauling the coal.

4. *Burton-Sutton* was the last depletion case before this Court and that was decided eight years ago. Mr. Justice Black, Mr. Justice Frankfurter and Mr. Justice Douglas dissented. Mr. Justice Jackson took no part in the consideration or decision of it.

B.

With Respect to the Income Issue.

1. The decision of the Court of Appeals conflicts with the principles established by this Court in *Blair v. Commissioner,* 300 U.S. 5 (1937).

Blair involved a taxpayer who transferred all of his interest in income-producing property to members of his family. This Court held that he was not taxable with the income received by the transferees. It said that the "one who is to receive the income as the owner of the beneficial interest is to pay the tax."[20]

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20. 300 U.S. at 12. This type of case is to be distinguished from one where the taxpayer (a) assigns income which he is to earn in the future; (b) assigns the income (accrued or future) derived or derivable from property which he retains; or (c) assigns future income attributable to the rendition of past services. *Lucas v. Earl,* 281 U.S. 111 (1930); *Helvering v. Horst,* 311 U.S. 112 (1940); *Helvering v. Eubank,* 311 U.S. 122 (1940). The basis of those decisions was that "the assignor may realize income if he controls the disposition of that which he could have received himself and diverts payment from himself to the assignee as a means of procuring the satisfaction of his wants, the receipt of income by the assignee merely being the fruition of the assignor's economic gain." *Commissioner v. Sunnen,* 333 U.S. 591, 605-606 (1948). The *Blair* type of case is likewise distinguishable from the case where a taxpayer transfers income-producing prop-

Here, Vincent by virtue of his leases acquired an interest in the coal in place. But, neither those leases nor that interest produced any income of and by themselves. The income was produced by a severance and sale of the coal.

Thus, the crucial point in this case is whether, under the agreement which Vincent made with Vincent, Inc., Vincent transferred title to the severed coal to Vincent, Inc. (the Court of Appeals never mentioned, let alone resolved, that problem, even though it was specifically put before that Court). If he did, it would make no difference that that transfer constituted a gift of the coal; neither he nor the corporation would have received income from the making or the receipt of the gift.[21]

In the Vincent-Vincent, Inc. contract, Vincent leased his tipple to Vincent, Inc. and the corporation promised to pay him, as rent, 5¢ per ton for each ton of coal it loaded over the tipple. When this provision is read in the light of the corporate resolution that Vincent, Inc. "would operate the said coal without a

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erty to members of his family for a short period of time, retaining extensive control over it. The transferor is taxable with the income received by his transferee on the theory that one who gives income-producing property away for a short period of time, retaining control over it, must be considered the owner of it and thus is taxable with the income therefrom. *Helvering v. Clifford,* 309 U.S. 331 (1940); *Harrison v. Schaffner,* 312 U.S. 579 (1941).

21. *W. K. Frank Trust v. Commissioner,* 145 F. 2d 411 (3d Cir. 1944); *Estate of Farrier,* 15 T.C. 277 (1950). *Contra*: I. T. 3910, 1948-1 Cum. Bull. 15. See also, I. T. 3932, 1948-2 Cum. Bull. 7.

formal assignment of the leases * * * on the same basis as said operations would have been conducted if said assignment had been made", the conclusion is inescapable that Vincent transferred his interest in the coal, at least upon severance. Only in the event that Vincent, Inc. was to load its own coal over the tipple would an obligation to pay rent measured in such fashion have been inserted.

In a word, the only thing consistent with paying Vincent rent measured by each ton of coal loaded over the tipple was ownership of that coal. The fact that the transfer of title might have been a technical violation of the leases did not affect its validity as between Vincent and Vincent, Inc.[22] Thus, title to the income-producing property (the severed coal) was transferred absolutely to the transferee corporation. The cost of severing that coal was borne by the transferee, not the transferor. The cost of hauling it to the place of processing, together with processing costs, was borne by the transferee, not the transferor. Then, after all those things were done and after the coal was turned over to the buyer, the transferor came back into the picture and received the proceeds of sale. At that point, however, he was acting in a purely representative capacity on behalf of the transferee; only the corporation had a beneficial interest in the proceeds at that point.

We submit that this was clearly a *Blair* type of case and that the *Earl-Horst-Eubank* and *Clifford-*

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22. *Goldman v. Daniel Feder & Co.*, 84 W. Va. 610, 100 S.E. 400 (1919); *Johnston v. Landucci*, 21 Cal. 2d 63, 130 P. 2d 405 (1942).

Schaffner lines of cases had nothing to do with it else the controlling shareholder-officer of any corporation is taxable with the income derived by the corporation from property absolutely transferred to it by that shareholder. That is nonetheless true even though Vincent could have cancelled the contract on 30 days' notice; that power would have revested possession of the coal lands in Vincent, but he could not have recaptured, by cancellation, title to the severed coal. And to repeat, the severed coal was the income-producing property (like the interest transferred in *Blair*), not technical ownership of the leases.

Commissioner v. Sunnen, 333 U.S. 591 (1948), heavily relied upon by the Tax Court and the Court of Appeals, likewise is not applicable to this case.

There the taxpayer was an inventor-patentee, president of a corporation, and its controlling shareholder. He licensed the corporation to manufacture devices upon which patents had been applied for, in return for the payment of royalties by the corporation. Each party retained the power to cancel upon specified notice. Subsequently, the taxpayer gratuitously assigned the licenses to his wife, but not the underlying patent applications. This Court pointed out that *Sunnen* was somewhat of a hybrid case: "The problem here is whether any different result follows because the taxpayer assigned the underlying contracts to his wife in addition to giving her the right to receive the royalty payments."[23] It went on to hold Sunnen taxable on the royalties subsequently received by the wife, because (1)

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23. 333 U.S. 591, 604 (1948).

"As president, director and owner of 89% of the stock of the corporation, the taxpayer remained in a position to exercise extensive control over the license contracts after assigning them to his wife. The contracts all provided that either party might cancel without liability upon giving the required notice. This gave the taxpayer, in his dominant position in the corporation, power to procure the cancellation of the contracts in their entirety. * * * And once it is evident that such power exists, the conclusion is unavoidable that the taxpayer retained a substantial interest in the license contracts which he assigned";[24] (2) "The taxpayer's controlling position in the corporation also permitted him to regulate the amount of royalties payable to his wife";[25] (3) "The taxpayer remained the owner of the patents and the patent applications";[26] and (4) "There is absent any indication that the transfer of the contracts effected any substantial change in the taxpayer's economic status. * * * He was * * * able to enjoy, lease indirectly, the benefits received by his wife * * *."[27]

There are a number of basic, substantial differences between this case and *Sunnen*.

First, here there was no gratuitous assignment of income; the corporation was a purchaser for value of the coal by its promise to let Vincent use its money to pay off the lessors.

Second, income as such was not assigned in this case. Property was transferred, and much remained to be done

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24. 333 U.S. at 608.
25. *Id.* at 609.
26. *Ibid.*
27. *Id.* at 609-610.

by the transferee before any income could be realized from the property transferred. It was as though Vincent transferred a house to the corporation, which in turn refinished the house and sold it at a profit. Vincent would not have been chargeable with taxable income when the house was thus sold at a profit,[28] and that case presents no valid distinction from this one.

Third, there clearly was a substantial change in Vincent's economic status effected by the transfer. His son had a 12½% interest in the net earnings of the corporation. His son was 27 years old, and married. Certainly Vincent would not have been able to enjoy, even indirectly, any of the corporation's income distributed to the emancipated son. Moreover, both his wife and his son put up their own capital to acquire their interest in the net earnings of the corporation. Hence, since Vincent contracted to transfer his interest in the coal in return for the use of corporate income to discharge his liability to the lessors and since the combined interest of the wife and the son in the net earnings (25%) bore the same proportion to the total interest in the net earnings of the corporation as the amount of the capital which they con-

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28. In *Doyle v. Commissioner,* 147 F. 2d 769, 771 (4th Cir. 1945), the Court of Appeals said: "Let us suppose that Spilkins has bought for $1,000 a vacant parcel of realty located in a then residential part of a growing city. The years go by, business edifices crowd all about the Spilkins lot and Spilkins has a bona fide offer of $20,000 for the lot. Spilkins now gives the lot to his son who sells it for $20,000. The resultant gain is clearly taxable to the son and not to Spilkins. The same result would follow if Spilkins bought for $10 a share 100 shares of stock in the Universal Dirt Corporation and gave them to his son who swiftly sold the shares for $200 a share."

tributed ($2,000) bore to the total capital contributed ($8,000), any distribution of corporate earnings receivable by them in nowise was attributable to a deflection of Vincent's income to them. It was attributable to the capital which they invested in the corporation.

Fourth, in the *Sunnen* case, the flow of income was from the debtor corporation to Sunnen's assignee. The assignor had extensive representative and indirect powers with respect to the corporation from which flowed the income to the assignee. Accordingly, since the assignor continued to control the flow of income from the debtor to the assignee (like the control retained by the assignor in *Earl* because receipt of the assigned income was dependent upon the continued rendition of services by him), it was proper to treat Sunnen as the recipient of the income assigned.

Here, there was no flow of income from the corporation to an assignee of Vincent's. And there was no flow of income from Vincent to the corporation. To the contrary, there was a bona fide purchase by the corporation of his interest in the coal. But even if there were a gratuitous transfer of his interest in the coal, there still would have been no flow of income as such from him to the corporation. For upon the receipt of the transferred interest, the corporation would not have realized taxable income.

Now, after the corporation's non-taxable receipt of the interest in the coal, Vincent's contral, both in his representative capacity as officer and director and indirectly because of his shareholdings, came into play. That control was with respect to *property* from which gain

could be realized. But if that gain when realized were taxable to him by virtue of that control, then every cent of income received by any closely held corporation, derived from property (such as an apartment house, for example) transferred by shareholders who likewise are officers and directors, would be taxable to them. The corporate entity would be disregarded in every case, despite the fact that the corporation concerned, like Vincent, Inc., was organized and operated for a business purpose. But that is not the law.[29]

Moreover, Vincent's control in a representative capacity and indirectly as a shareholder was no more nor less with respect to the coal transferred during 1947 than it was in 1948 when the leases (and hence the coal) were transferred to the corporation. And nobody contends that a *Sunnen* situation blossomed from the trans-

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29. *National Carbide Corp. v. Commissioner,* 336 U.S. 422 (1949); *Moline Properties, Inc. v. Commissioner,* 319 U.S. 436, 438-439 (1943). See, also, *Commissioner v. Montgomery,* 144 F. 2d 313 (5th Cir. 1944). There the taxpayer assigned a building construction contract, not for personal services, to a corporation formed by the taxpayer, his wife and his brother. The primary voting stock was issued to the taxpayer and his wife, and another class of stock, which carried voting rights only in extraordinary circumstances, was issued, one to the brother and the remainder gratuitously to the taxpayer's children. The taxpayer was president and general manager of the corporation. The other party to the contract apparently did not assent to the assignment. Prior to the assignment, the taxpayer had realized in the year of assignment, some $81,000 of income from the contract. Thereafter, in the same year, the corporation realized about $80,000 of income from the contract. The Court held that the income derived from the contract after the assignment was taxable to the corporation.

fer of the leases in 1948. Thus, the fact that Vincent, in a representative capacity and indirectly as a shareholder, had some control over the coal which he transferred to the corporation must not be significant.

That brings us to the final point involved with respect to *Sunnen*: is it material that because the agreement between Vincent and the corporation was cancellable by either party upon 30 days' notice, Vincent had the power to recapture the coal in place and thus choke off Vincent, Inc.'s income? Clearly it is not. For as a practical matter, Vincent had that very same power in 1948 even after he assigned the leases to the corporation. Then he could have dissolved the corporation, thus shutting off its income completely. Then he could have recaptured the very leases assigned, through their distribution in kind to him.

Consequently, since the Commissioner has determined that the corporation was taxable with the net income derived from the sale of the coal after January 1, 1948, even though Vincent had the power to dissolve the corporation at any time and thus recapture the leases, the power to cancel must be of no moment. For this Court has often said that federal income taxation is an intensely practical matter.[30] It has likewise said that income tax cases do not turn on "attenuated subtleties."[31] Finally, the power to cancel related only to the leases, and not to the severed coal, the income-producing property.

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30. E.g., *Harrison v. Schaffner*, 312 U.S. 579, 582 (1941).

31. *Lucas v. Earl*, 281 U.S. 111 (1930).

In summary, of all the four factors set down as significant in *Sunnen,* only one—the power to cancel—holds but a remote likeness to this case. That, we believe, forecloses its analogy here. To reach any other conclusion is to say that two automobiles must be Fords because they both sport hub-caps.

Finally, in regard to *Sunnen,* we should like to point out that while the Commissioner professes never to have harbored the thought "that income validly earned by a closely held corporation should be taxed to its sole shareholder," he nevertheless argues that Vincent should be taxed with the $808,000 "because of his control of his company."[32]

VII.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ or writs of certiorari should be granted.

Respectfully submitted,

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32. Commissioner's Brief in the Court of Appeals, p. 33.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 194

GREGORY RUN COAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

J. E. VINCENT, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

J. E. VINCENT COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

J. E. VINCENT COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (App. 52-74)[1] is reported at 212 F. 2d 52. The findings of

[1] "App." refers to the Appendix to the Petition for Certiorari.

fact and opinion of the Tax Court (App. 1-50) are reported at 19 T. C. 501.

JURISDICTION

The judgments of the Court of Appeals were entered on April 9, 1954. (App. 79-82.) The petition for a writ of certiorari was filed on July 6, 1954. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether petitioners must exclude from gross income, for purposes of computing their respective percentage depletion deductions under Sections 23(m) and 114(b)(4) of the Code, the sums paid to coal strippers for mining and transporting coal.

2. Whether $808,064.46 received by J. E. Vincent from sales of coal and paid over by him to J. E. Vincent Company, Inc., was income to J. E. Vincent individually.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and

for depreciation of improvements, according to the peculiar conditions in each case * * *.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION

* * * * *

(b) *Basis for Depletion.—*

* * * * *

(4) [as amended by Sec. 145, Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 124, Revenue Act of 1943, c. 63, 58 Stat. 21] *Percentage Depletion for Coal* * * *

(A) *In General.*—The allowance for depletion under section 23(m) shall be, in the case of coal mines, 5 per centum * * * of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. * * *.

(B) *Definition of Gross Income From Property.*—As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "min-

ing", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The term "ordinary treatment processes", as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment * * *.

* * * * *

(26 U. S. C. 1952 ed., Sec. 114.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(m)-1. DEPLETION OF MINES, OIL AND GAS WELLS, OTHER NATURAL DEPOSITS, AND TIMBER; DEPRECIATION OF IMPROVEMENTS. —Section 23(m) provides that there shall be allowed as a deduction in computing net income in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements. Section 114 prescribes the bases upon which depreciation and depletion are to be allowed.

Under such provisions, the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions. An economic interest is possessed in

every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the severance and sale of the mineral or timber, to which he must look for a return of his capital. But a person who has no capital investment in the mineral deposit or standing timber does not possess an economic interest merely because, through a contractual relation to the owner, he possesses a mere economic advantage derived from production. Thus, an agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production or to share in the net income derived from the interest of such owner does not convey a depletable economic interest.

* * * * *

STATEMENT

There are three taxpayers involved in this proceeding: J. E. Vincent, an individual; J. E. Vincent Company, Inc. (hereinafter referred to as Vincent, Inc.), a family corporation organized by Mr. Vincent on April 30, 1947; and the Gregory Run Coal Company (hereinafter referred to as Gregory), a corporation organized on June 11, 1945, by Vincent and a Mr. Williamson.[2] The

[2] B. H. Swaney & Sons, Inc., and Swaney Contracting Company, the other parties to two of the stripping contracts herein involved in the depletion allowance question, will also be

cases arise from transactions connected with coal strip-mining operations conducted on land in Gregory's Run and Lambert's Run, West Virginia, under leases which Vincent obtained from various lessors.

1. The depletion issue herein arises in two different factual contexts, one relating to operations in Gregory's Run and the other to mining activities in Lambert's Run. Specifically, the question in the first context is whether Gregory, in computing its depletion deduction for the tax years 1945 and 1946, was required to deduct from the gross income of its mining property the amounts it accrued and paid at the rate of $1.55 per ton during these years to Summit Fuel Company (hereinafter called Summit), with the result that Summit could take a depletion deduction on its gross income. The question is virtually the same in the second context, involving payments made in 1947-1949 by Vincent and Vincent, Inc., to Swaney Contracting and Swaney, Inc., at the rate of $2 per ton and $2.18, respectively, with adjustments for market price fluctuations. The pertinent facts relating thereto are as follows:

On June 11, 1945, Vincent caused the organization of both Gregory and Summit, with Vincent and Williamson each acquiring 50 percent of the stock

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before this Court in a companion case. The Commissioner was granted an extension of time to August 7, 1954, by Mr. Justice Burton to file a conditional cross petition in the *Swaney* case. This will be necessary to protect the revenue since the taxpayers in the two cases are rival claimants to the same depletion allowance.

of each corporation. On the next day, Vincent assigned certain of his coal leases to Gregory, whereupon Gregory and Summit entered into a joint agreement for the mining of the leased property and the transportation and loading of the coal. Under the agreement this was to be accomplished by the use of the tipple and strip-mining equipment belonging to Gregory, the use of motor vehicles belonging to Summit, and labor furnished by Summit. Summit was to mine and haul the coal to the tipple, process it, and load it on the railroad cars, and Gregory was to sell it. Summit also agreed to refill and recondition the surface of the mined area, in accordance with the laws of West Virginia; to carry workmen's compensation, public liability and property damage insurance; and to indemnify Gregory for all claims arising out of the operations. Gregory was to obtain the permit required by state law, bear the expense of the bond, and pay the cost of the refill. (App. 56-57.)

In accordance with the agreement, Summit from June 11, 1945, to December 31, 1945, stripped and hauled coal from the leased properties and was paid by Gregory the sum of $222,617.43 therefor. In 1946 Summit stripped the land and hauled the coal until July 1, and thereafter Gregory did the stripping and Summit the hauling. During 1946 Gregory paid Summit $189,005.63 for stripping and $86,367.19 for hauling. The amounts paid by Gregory to Summit arose from the sale of the coal by Gregory and were paid in accordance with the contract between Gregory and Summit, which pro-

vided that the latter "for its participation in this joint adventure" should receive $1.55 per ton for all the coal mined, transported and loaded by it. Either party had the right to cancel the agreement except that in case Gregory served notice of cancellation, Summit should have the right to mine and remove all the coal which had been uncovered up to that time. The amounts paid were reported as income by Summit in 1945 and 1946. (App. 59-60.)

The Commissioner held that Gregory should exclude these amounts from its gross income in computing its depletion allowance. The Tax Court, overruling the Commissioner, decided in favor of Gregory on this point. (R. 59.) On appeal, the Court of Appeals held with the Commissioner that the rights of the producer were completely dependent upon the extraction of a salable product and that consequently Summit was entitled to share in the depletion allowance which was designed to give compensation to persons interested in a wasting asset. (App. 73-74.)

A similar question arises with respect to operations on Lambert's Run. On December 24, 1945, Vincent entered into a contract with Swaney Contracting Company, a West Virginia corporation, wherein he employed the corporation to strip-mine coal covered by leases to Vincent on Lambert's Run. Under the contract Vincent provided the sidetrack and the tipple and the men to operate them, paid their wages, and had complete charge of the coal after it was loaded or dumped at the tipple. Swaney Contracting furnished the equip-

ment and employees to mine and haul 25,000 tons of coal a month and bound itself to backfill and restore the land in accordance with the terms of the lease. Swaney Contracting agreed to secure the necessary bonds and mining permits required by the state, and to maintain adequate public liability and property damage insurance for its operations. Vincent was to carry insurance on the tipple and side-track. It was expressly provided that in all respects Swaney Contracting was to operate as an independent contractor. Swaney Contracting was to be paid for its services on the basis of the coal accepted and paid for by the Weaver Company, the sales agent of Vincent, at the rate of $2 per net ton. But Vincent remained liable for the payment and there were provisions for the adjustment of the basic payment in the event of a change in the sales price of the coal. The contract was not cancellable except on specified defaults by the parties or in the event that the sales price of the coal fell below $2.76 per ton. Vincent remained liable to pay the royalties due to the lessor under the leases. (App. 60-61.)

Another stripping agreement was made on April 26, 1947, between Vincent and B. H. Swaney & Sons, Inc., another West Virginia corporation, with respect to property on Lambert's Run. Swaney, Inc., was to strip, load and haul to a tipple operated by Vincent all the coal under the lease that was not being operated by another contractor. The provisions of the agreement were similar to those in the contract between Vincent and Swaney

Contracting, except that the compensation to Swaney, Inc., was to be at the rate of $2.18 per ton. Provision was made for adjustment on this compensation in the event of changes in the sales price of the coal. Vincent had the option to cancel the contract if the price of the coal fell to a point where the operations were unprofitable to him. (App. 61.)

Both of the Swaney Companies carried out their agreements. The price of coal increased during the period of their operations. Each of them received compensation in excess of the base amount per ton specified in the contracts. (App. 61-62.)

Vincent and J. E. Vincent Company, Inc., both contended that there was no transfer of a depletable interest to either of the Swaney Companies under the contracts described above and hence that Vincent or Vincent Company, Inc., was entitled to the statutory depletion deduction. The Tax Court sustained this contention but was reversed by the Court of Appeals for the same reasons noted above.

2. Vincent organized Vincent, Inc., to have it take over his interest in a lease from the Dawson Coal Company located in Lambert's Run. He received 60 shares of stock, his wife 10 shares, and his son 10 shares, with all shares being paid for at the rate of $100 per share. There is evidence that Vincent was in bad health and desired that his son, who had returned from military service, should have an interest in the business. Dawson, however, refused to permit Vincent to assign the lease to the new corporation. Thereupon, on May

15, 1947, the directors of the corporation adopted a resolution that the corporation would operate the coal without a formal assignment of the leases just as if an assignment had been made; and on the same day the corporation entered into a contract with Vincent whereby Vincent leased to it the tipple, sidetrack and appurtenances, and gave it the right to load over the tipple the coal mined on the leased premises, in consideration for which the corporation agreed to pay Vincent 5 cents per ton of coal loaded over the tipple. The corporation obligated itself to operate the tipple and to keep it and the sidetrack in good working condition. (App. 62-63.)

The agreement provided, however, that Vincent was to continue to operate in his own name the Lambert Run strip mines and was to be regarded as the operator of the coal, subject only to a contract, dated April 26, 1947, between him and B. H. Swaney & Sons, Inc., for the stripping of the coal. A contract between Vincent and the Weaver Company for the sale of the coal was not assigned to Vincent, Inc.; and Vincent was to continue to receive payment from his sales agent for all the coal loaded over his tipple and sidetrack, and was to pay out of the proceeds of the sales brokerage, royalties for the coal, surface rights, rights of way, rental on the sidetrack and buildings and other similar royalties. After deducting all these payments Vincent was to pay the net proceeds of the sales to the corporation. Out of such net proceeds the corporation was to pay Swaney, Inc., the

amounts payable for stripping the coal. The contract between Vincent and the corporation was cancellable by either party on 30 days notice. (App. 63.)

Between June 30 and December 31, 1947, Vincent turned over to Vincent, Inc., $808,064.46 as the net proceeds from the sale of the coal under the contract. The corporation in turn paid Swaney Contracting Company and Swaney & Sons, Inc., $448,379.25, and also paid other expenses in the aggregate sum of $117,364.42. The Court of Appeals observed that the result was that the corporation, without having any responsibility for the mining or the sale of the coal, made a handsome profit merely for the operation of the tipple and subsidiary services. (App. 63-64.)

The Commissioner held that the $808,064.46 which Vincent turned over to the corporation during 1947 was his income and as such was taxable to him, and allowed him an additional deduction in the sum of $565,743.67 actually paid out for expenses by Vincent, Inc., during the year 1947. The Tax Court and the Court of Appeals both sustained this holding. (App. 64.)

ARGUMENT

1. *The depletion issue.*

This issue presents no question calling for review by this Court. There is no conflict of decisions and the issue is merely one involving the application of the "economic interest" concept—which this Court first adopted in *Palmer* v. *Ben-*

der, 287 U. S. 551—to the particular contracts here involved in order to allocate the statutory depletion allowance.

Section 23(m) of the Internal Revenue Code, *supra,* pp. 2-3, permits the deduction of a reasonable allowance for depletion in the case of mines. Section 114(b)(4) of the Code, *supra,* pp. 3-4, provides that percentage depletion for coal mines shall be 5 per centum of the gross income from the property, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer. Section 29.23(m)-1 of Treasury Regulations 111, *supra,* pp. 4-5, provides that the owner of an "economic interest" in mineral deposits is allowed annual depletion deductions, and states that such an interest is possessed in every case in which the taxpayer has acquired, by investment, *any* interest in minerals in place and secures, by *any* form of legal relationship, income derived from the severance and sale of the mineral to which he must look for a return of his capital.[3] A taxpayer's "economic interest" is marked by the "possibility of profit" from the use of his rights over production, "dependent solely upon the extraction and sale of the [mineral]." *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U. S. 25, 34-35. This rule of *Burton-Sutton* applied settled principles laid down in a host of decisions which had dealt authoritatively with the depletion concept. See *Kirby Petroleum Co.* v. *Commissioner,* 326 U. S.

[3] The language of the Regulations is taken verbatim from *Palmer* v. *Bender,* 287 U.S. 551, 557.

599; *Anderson* v. *Helvering,* 310 U. S. 404; *Helvering* v. *Bankline Oil Co.,* 303 U. S. 362; *Thomas* v. *Perkins,* 301 U. S. 655; *Helvering* v. *Twin Bell Oil Syndicate,* 293 U. S. 312; *Palmer* v. *Bender, supra.*

It is quite clear that the right to royalty payments, *i.e.,* payments made to lessors based on a flat rate per unit of production, meets the test as to whether one holds a depletable economic interest in the mineral in place. *Kirby Petroleum Co.* v. *Commissioner, supra,* p. 604; *Anderson* v. *Helvering, supra,* p. 409. As the Court of Appeals correctly held, after a lengthy discussion of *Burton-Sutton,* there is no material difference between the right to a specified percentage of the proceeds of the production (where depletion is always allowed) and the right to compensation fixed by the selling price of the coal, adjustable to changes in the market price. (App. 72-73.) In respect to both the Swaneys and Summit, as the Court of Appeals observed, "depletion was dependent upon production and in both the possibility of profit from the use by the operator of his rights over production was dependent solely upon the extraction and sale of the product and gave him an economic interest therein." (App. 73.)

Taxpayers' argument here (Pet. 11-17) is based upon a strict insistence that title to the severed coal rested in neither the Swaneys nor Summit. But it is well established that an economic interest in a mineral property does not mean title to, or ownership of, the mineral deposits. *Lynch* v. *Alworth-*

Stephens Co., 267 U.S. 364; *Burnet* v. *Harmel*, 287 U.S. 103; *Kirby Petroleum Co.* v. *Commissioner*, *supra*, p. 603. In *Burton-Sutton*, the holder of a right to a payment of 50 percent of the net profits from operations was held to have a depletable economic interest; and this right clearly did not include title to the severed mineral. The answer to taxpayer's other contention (Pet. 17-19), that the Swaneys and Summit had no "income from the property," is that the price per ton agreed upon was geared to predicated market prices and certain estimated costs for the strippers. Such a right constitutes a sharing of the proceeds from the production and sale of the coal. Accordingly, each stripper had an economic interest which was being depleted with each ton of coal produced and sold.

2. *The $808,064.46 item.*

Both courts below held that the $808,064.46 turned over by Vincent to Vincent, Inc., between May 1 and December 1, 1947, must be considered income earned by Vincent as a coal operator and therefore taxable to him. (App. 45, 66.) This Court has considered many times this type of issue—an attempt by a taxpayer to assign income and thereby escape tax liability thereon. See *Lucas* v. *Earl*, 281 U. S. 111; *Helvering* v. *Clifford*, 309 U. S. 331; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Harrison* v. *Schaffner*, 312 U. S. 579. Cf. *Blair* v. *Commissioner*, 300 U. S. 5. The prior decisions of this Court provide ample

guidance for the lower courts in this area of tax law, and there is no need for further review in this case.

After an abortive attempt to assign the Dawson coal lease, frustrated by the lessor's refusal to consent thereto (Ex. 12-L), Vincent and his closely-held corporation, Vincent, Inc., entered into an agreement (Ex. 2-B), by which Vincent was to pay over to Vincent, Inc., certain "net proceeds" after paying stated royalties and expenses. However, the agreement specifically provided that Vincent, and not the corporation, was to continue to operate the strip mines "in his own name" and that he was to "be regarded as the operator" of the coal (App. 45, 67). Fully in keeping with the specific wording of the agreement, Vincent, as an individual, failed to assign either his Swaney stripping contracts or his sales agreement. As the Court of Appeals observed (App. 67), these were "the productive and essential factors of the business", with the operation of the tipple by the corporation being merely a "necessary" but "routine" step in the processing of the coal and having little influence on the success or failure of the business. The $808,064.46 was clearly income attributable to Vincent's leaseholdings and the operation thereof, and tax liability thereon cannot be escaped by an agreement to pay over so-called "net proceeds" to a closely-held corporation.

Taxpayer's case is bottomed on a strained attempt to rely on *Blair* v. *Commissioner*, 300 U.S. 5,

after assuming that title to severed coal passed from Vincent to his corporation before the coal was sold. As we understand it, taxpayer's whole argument (Pet. 22-23) is that since Vincent, Inc., was obligated to pay Vincent tipple rent, calculated on the amount of coal loaded over the tipple, Vincent cannot with consistency be said to have retained title to any coal so loaded. But the point is, as both courts below in effect held, that the whole arrangement was simply a transparent device for transferring income in reality earned by Vincent to the closely-held corporation. In *Blair* there was "a valid assignment" of an equitable interest, whereas here there was no assignment of the coal lease, of the sales agreement, or of the stripping contract. In fact, Vincent himself continued to receive payment for the coal from his sales agent; and taxpayer admits that an attempt to transfer title to the coal would have violated the Dawson lease agreement. (Pet. 22.)

Even assuming *arguendo* that Vincent, Inc., did receive property rights of sorts, the Tax Court correctly pointed out that the retention by taxpayer of the Dawson lease and other rights and obligations, including the right of cancellation, would require taxation of the income to him since he controlled the flow of income. *Commissioner* v. *Sunnen*, 333 U.S. 591.

CONCLUSION

The decision below is correct and there is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

NO. 194

GREGORY RUN COAL COMPANY, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NO. 194

J. E. VINCENT, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

NO. 194

J. E. VINCENT COMPANY, INC., Petitioner

v.

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NO. 194

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v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

This reply to the Commissioner's brief in opposition is submitted primarily for the purpose of aborting any misimpression as to the importance of this case, at least insofar as the depletion issue is concerned, which might be engendered by the brief in opposition.

The Commissioner states that "the issue is merely one involving the application of the 'economic interest' concept * * * to the particular contracts here involved in order to allocate the statutory depletion allowance."[1] Thus, he seems to say that this case is not important because it involves some contracts peculiar in themselves.

In the petition, we printed a letter from the National Coal Association which states that the precise issue involved here is likewise involved in many other cases between members of the Association and the Commissioner. In all of these cases, as here, the question is whether a coal miner or stripper who does not share either the proceeds of production or the produced coal itself, is entitled to apply the percentage depletion deduction to his compensation.

Under a contract between an owner, lessee or transferee on the one hand and a coal stripper on the other, the stripper either shares the proceeds of production (or the produced coal itself) or he is paid compensation for his services. The Commissioner has taken the position in many cases involving members of the Association, as here, that the stripper is entitled to a percentage depletion deduction even though he does not share the proceeds of production or the produced coal itself under the con-

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1. Commissioner's Brief in Opposition, pp. 12-13. Hereinafter, that brief will be referred to as "CB".

tracts involved. And he has also taken the position, on the other side of the fence and under the same contracts, that the stripper likewise is not entitled to the percentage depletion deduction.

Thus, this is not a peculiar case, significant only to itself. This is not a case which involves "merely" the application of the economic interest concept to some contracts, unlike others in the coal industry. For the contracts embedded in the other cases have the same legal import as those in this case. And finally, in this regard, we submit it is most significant that the Commissioner has refrained from directly challenging the assertion (appropriately buttressed by the letter from the Association) that this case is of extreme and far-reaching importance. Instead, he seems to have chosen, by indirection, to create the misimpression that a decision here will not be felt beyond the confines of this case because, as he pictures it, the issue "merely" is one of applying the economic interest concept "to the particular contracts here involved".

Turning now toward the conclusion of this brief, we should like briefly to notice, in passing, several items in the Commissioner's and the Swaneys' briefs.

First, although the Commissioner and the Swaneys contend (apparently believing it is crucial) that the Swaneys either had *"a* share *upon production"*[2] or participated in "a sharing of the proceeds of production",[3] they offer no real explanation how that phenomenon

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2. CB 15.

3. Brief in Opposition at No. 259, pp. 13, 14. The Swaneys' brief will be referred to herein as "SB".

could have occurred under a contract which provided that the Swaneys were entitled to their compensation even though there never were any proceeds to share and which clearly did not provide for a division of production.

Second, the Commissioner proclaims that the Court of Appeals "correctly held" that "there is no material difference between the right to a specified percentage of the proceeds of production (where depletion is always allowed) and the *right to compensation* fixed by the selling price of the coal, adjustable to changes in the market price."[4] This is totally inconsistent with his answer to the petitioners' argument based upon the statutory language, "gross income from the property",[5] that "the price per ton agreed upon was geared to predicated market prices and certain estimated costs for the strippers. Such a right constitutes a sharing of the proceeds from the production and sale of the coal."[6]

If the Court of Appeals "correctly held" that the Swaneys had a "right to compensation", then it necessarily follows that they never shared either the proceeds from the sale of the coal or the coal itself. In short, if a person merely is paid compensation for digging and hauling coal, he does not share the production or its proceeds as such, whether he is paid on a piecework, hourly or some other basis. The mechanics by which his compensation is fixed do not alter the essential nature of the payments to him.

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4. CB 14. Emphasis added.
5. Petitioners' Petition, pp. 17-19.
6. CB 15.

Fourth, the Swaneys argue that they held an economic interest "because of their assumption of the burden of exploitation, the obligation to develop and produce the coal."[7] Then they say that "it is the assurance of *a* share *upon production* which entitles the Swaney companies to depletion."[8] If "a share upon production" is the basis of a right to the percentage depletion deduction, then the means by which that right is acquired is immaterial, *i.e.,* by shouldering "the burden of exploitation". And, of course, the Swaneys never shared the production or its proceeds any more than a coal miner on an hourly or piecework basis shares the production or its proceeds because his compensation is derived from the owner's sale of the coal.

In closing, we should like to state that neither this Court nor any other court has ever held that a person who is under a contractual duty to extract a mineral and who has no contractual right whatsoever to share production as such or the proceeds of production, *acquires* a depletable interest by virtue of such a contract. *Spalding v. United States,*[9] cited by the Swaneys, involved a case where the taxpayer "had the right to, and did, receive and retain as its own 61⅔% of the net

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7. SB 10. They under-pin this argument in spots with references to the "miles of roads" which they allegedly built, all of which is pure hearsay in this case, for it came into a case between the Commissioner and the Swaneys alone. Be that as it may, the road-building activity of the Swaneys is insignificant, if any validity is to be attributed to GCM 26290, 1950-1 Cum. Bull. 42, 45: "The circumstance that stripping contractors at times engage in road building or other forms of activity also appears to be immaterial." The Swaneys rely upon GCM 26290. SB 14.

8. SB 13. Emphasis not supplied.

9. 97 F. 2d 697 (9th Cir. 1938), *cert. denied,* 305 U.S. 644 (1938).

proceeds of the oil and gas so produced."[10] Quite obviously, the taxpayer there shared the proceeds of production. *Eastern Coal Corp. v. Yoke,*[11] relied upon by the Swaneys, was a case where the taxpayer was found by the court to have continued in substance as lessee of all the property, instead of merely one-eighth thereof as contended by the Commissioner, and on that basis to have *retained* an economic interest in the coal. In *North Range Mining Co.,*[12] cited by the Swaneys, the Board expressly stated that "the question hinges upon the construction of the agreement of November 1, 1933, and particularly that portion of the agreement relating to the iron ore to be mined and *sold* to Ford."[13] If the stripper sells the coal on his own behalf, by hypothesis he must have owned it.

Finally, the *Burton-Sutton case,*[14] relied upon by both the Commissioner and the Swaneys, involved the ultimate question as to whether an assignor of coal leases who retains a right to share the net proceeds with the assignee, *retains* a depletable interest upon the assignment. There, the assignor shared the proceeds of production. Here the question is whether the stripper *acquired* a depletable interest under a contract by which he splits neither the proceeds of production nor the production itself, but instead is paid what has twice been characterized below as "compensation" for his services in the process of production.

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10. *Id.* at 700.
11. 67 F. Supp. 166 (N.D.W.Va. 1946).
12. 46 B.T.A. 296 (1942).
13. *Id.* at 300. Emphasis added.
14. 328 U.S. 25 (1946).

It is respectfully submitted that the petition for a writ or writs of certiorari should be granted.

Respectfully submitted,

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